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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1940.

No. 254.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

EDWARD MALLINCKRODT, JR., et al., Trustees etc.,
Respondents.

On Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

BRIEF FOR RESPONDENTS IN OPPOSITION.

HARRY W. KROEGER,
Attorney for the Respondent Trustees.

DANIEL N. KIRBY,
Of Counsel.

St. Louis Law Printing Co., 415 North Eighth Street. CEntral 4477.

INDEX.

	Page
Opinions Below	1
Jurisdiction	2
The Question Presented	2
Statutes and Regulations Involved	2
Statement	4
Argument	8

Cases Cited.

Jane Holding Corporation v. Guy T. Helvering, Commissioner of Internal Revenue, No. 999, October Term, 1939	8
Jane Holding Corporation v. Commissioner of Internal Revenue, 38 B. T. A. 960	1, 9
Guy T. Helvering, Commissioner of Internal Revenue, v. Jane Holding Corporation, 109 F. (2d) 933	1, 9

Statutes and Regulations Cited.

Regulations 74, Article 332	4
Revenue Act of 1932, Sections 41, 42, 43, 48 (June 6, 1932, c. 209, Sections 41, 42, 43, 48, 47 Stat. 185, 187)	2

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OPINIONS BELOW.

The opinion of the United States Board of Tax Appeals appears at pages 40, 56 of the record and is reported in 38 B. T. A. at 960, 972. The opinion of the United States Circuit Court of Appeals for the Eighth Circuit appears at pages 523, 543 of the record and is reported in 109 F. (2d) 933, 944.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered on February 27, 1940 (R. 546). Upon motion of the Government (R. 567), said judgment was set aside on April 18, 1940 (R. 569), and a new judgment was entered on that day (R. 570). The petition for writ of certiorari was filed by the Government on July 18, 1940, invoking the jurisdiction of this Court under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

THE QUESTION PRESENTED.

The question presented is: Whether Edward Mallinckrodt, Jr., and St. Louis Union Trust Company, as Trustees, whose books were kept on a cash receipts and disbursements basis, are liable for 1932 income taxes in respect of $171,249.36, being the amount of interest which was accrued in their favor on the books of Jane Holding Corporation for the year 1932, although the Trustees did not in fact receive payment thereof and the corporation did not have liquid assets sufficient to enable it to pay any substantial part of said amount and could not have paid said amount without selling or mortgaging its real estate holdings.

STATUTES AND REGULATIONS INVOLVED.

The following sections of the Revenue Act of 1932 are involved:

> Sec. 41. General Rule.
>
> The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accord-

ance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year, as defined in section 48, or if the taxpayer has no annual accounting period, or does not keep books, the net income shall be computed on the basis of the calendar year. (June 6, 1932, c. 209, sec. 41, 47 Stat. 185.)

Sec. 42. Period in Which Items of Gross Income Included.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. (June 6, 1932, c. 209, sec. 42, 47 Stat. 185.)

Sec. 43. Period for Which Deductions and Credits Taken.

The deductions and credits provided for in this title shall be taken in the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. (June 6, 1932, c. 209, sec. 43, 47 Stat. 185.)

Sec. 48. Definitions.

* * * * * * *

(c) *Paid, incurred, accrued.*—The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this part. (June 6, 1932, c. 209, sec. 48, 47 Stat. 187.)

The Regulation involved is Article 332 of Regulations 74, reading as follows:

> "Income not reduced to possession.—Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to posssession. To constitute receipt in such a case the income must be credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition. A book entry, if made, should indicate an absolute transfer from one account to another. Where a corporation contingently credits its employees with bonus stock, but the stock is not available to such employees until some future date, the mere crediting on the books of the corporation does not constitute receipt."

STATEMENT.

The facts out of which the controversy arose may be summarized as follows:

Jane Holding Corporation was, at all times material to the issues, a corporation under the laws of Missouri, operating exclusively as a real estate holding corporation. Prior to April 17, 1918, it was the owner of various parcels of real estate located in New York and St. Louis (R. 91).

On April 17, 1918, Edward Mallinckrodt, Sr. (since deceased), was the owner of all of the shares of the capital stock of Jane Holding Corporation (R. 43, 89). By his indenture of trust dated April 17, 1918 (Pet. Ex. 2, R. 115), Edward Mallinckrodt, Sr., created the Edward Mal-

linckrodt Trust, also known as the "Arcade Trust," and transferred to it, among other property, his shares of stock in Jane Holding Corporation. The Trust continued at all times after April 17, 1918, to be the sole owner of all the stock of the corporation (R. 43, 95).

Edward Mallinckrodt, Jr., son of the trustor, was co-trustee of the trust with St. Louis Union Trust Company (R. 115), and was also a beneficiary of the Trust entitled, after payment of certain debts and obligations, to receive, upon his demand, the residue of the income of the Trust, after the payment of an annuity to his wife (R. 43, 123, 124).

At the time of the creation of the trust Mr. Mallinckrodt, Sr., was, through the instrumentality of Jane Holding Corporation and its subsidiary, Finance and Mortgage Corporation (R. 43, 89), engaged in the erection of a nineteen-story store and office building located in downtown St. Louis, known as the "Arcade Building," and one of the purposes of the creation of the trust was to relieve Mr. Mallinckrodt, Sr., of the difficulties of supervision of construction (R. 88).

Commencing in the year 1918, the Trustees made advances to Jane Holding Corporation for the purpose of enabling it to defray the cost of construction of the Arcade Building and to discharge liens and encumbrances thereon, such advances being recorded in an open account on the books of Jane Holding Corporation to the credit of the Trustees (R. 43, 90, 100, 105, 156). The aggregate amount of the advances by the Trustees was $3,280,744.00, of which $3,010,000.00 was in cash (R. 105, 155, 156).

In the years intervening between January 1, 1918, and December 31, 1932, the open account was augmented by annual accruals of interest in favor of the Trustees and was reduced by various repayments to the Trustees (Pet.

Ex. 3, R. 92, 143-149). During such years the books of Jane Holding Corporation were kept on an accrual basis, a practice initiated by Mr. Mallinckrodt, Sr. (R. 43, 92). The accounts of the Trustees were kept on a cash receipts and disbursements basis in conformity with the uniform practices of the St. Louis Union Trust Company in respect to all its trust estates (R. 44, 100). The amounts of interest accrued in favor of the Trustees were deducted from income on the income tax returns of Jane Holding Corporation (R. 45, 92). They were not included in the income tax returns of the Trust (R. 45, 107).

In all of the years 1919 to 1932, both inclusive, excepting three, Jane Holding Corporation sustained net losses as disclosed on its income tax returns (R. 44). The net loss so sustained over the entire period amounted to $968,-870.30.

It has been stipulated that the returns of Jane Holding Corporation and of the Trustees were audited by agents of the Commissioner for each of the years 1919 to 1931, both inclusive, and that only changes which have no relation to the matters in controversy were made in them (R. 108).

At the end of the year 1932 Jane Holding Corporation credited the Trustees on its books with accrued interest in the amount of $171,249.36 on outstanding balances in the open account during that year (R. 45, 149). No part of said amount of $171,249.36 was in fact paid to the Trustees (R. 97, 101, 227). During the year 1932 Jane Holding Corporation had incurred a net loss of $130,193.36 as disclosed on its return (R. 44).

At the end of the year 1932 the assets of Jane Holding Corporation consisted of real estate having a book value, less depreciation, of $5,767,851.18, cash in the amount of $43,907.13, and prepaid items and suspense accounts aggregating $40,799.98 (R. 47, Pet. Ex. 5, R. 151).

The testimony was to the effect that Jane Holding Corporation required its cash as working capital and could not have paid said amount of interest or any substantial part thereof without jeopardy to its financial condition and without liquidating its real estate and that such liquidation was not feasible (R. 95).

The Commissioner of Internal Revenue, in his deficiency letter dated February 20, 1935 (R. 493), adjusted the net income of the Trustees for 1932 by adding thereto the amount of said interest accrued on the books of Jane Holding Corporation, to wit, $171,249.36, treating said amount as "constructively received, representing taxable income to the Trust even though not actually received" (R. 494).

The Commissioner's determination was sustained by the Board of Tax Appeals (R. 57), but the decision of the Board was reversed by the Circuit Court of Appeals (R. 544). The Commissioner seeks review by his petition for writ of certiorari filed herein on July 18, 1940.

ARGUMENT.

It is stated in the petition for writ of certiorari herein that such petition was filed solely to protect the Government's interests pending the action by this Court upon petition for rehearing in *Jane Holding Corporation v. Guy T. Helvering, Commissioner of Internal Revenue,* No. 999, October Term, 1939, and that, in the event of a denial of the petition for rehearing in the *Jane Holding Corporation* case, the Government does not wish to press the petition in the instant case (Pet. p. 7). No reason for the granting of the writ in the instant case is urged, excepting that the petitioner contends that if a writ be granted in the *Jane Holding Corporation* case and the judgment of the Circuit Court of Appeals therein reversed, "it would probably follow that the judgment below in the present case should likewise be reversed" (Pet. p. 8).

The interrelationship between the two cases requires clarification.

The *Jane Holding Corporation* case arose from a separate notice of deficiency issued by the Commissioner of Internal Revenue on August 25, 1936, wherein he determined the income tax liability of the corporation, a separate entity, for a year subsequent to that here involved, namely, 1933 (R. 28). The deficiency so determined by the Commissioner was based in substantial part upon the Commissioner's holding that, when in 1933 the respondents herein, being the sole stockholders of Jane Holding Corporation, canceled the indebtedness owing to them by Jane Holding Corporation upon the open account referred to in the statement herein, so much of the amount canceled as equaled the total amount of accruals of interest in the open account during prior years, namely, $2,510,222.07, constituted taxable income to the corporation realized in 1933.

The Jane Holding Corporation having filed with the Board of Tax Appeals its petition for redetermination (R. 5), its case and the instant case involving the Trustees' tax liability for 1932, were for convenience consolidated, and tried at one time.

The Board reversed the Commissioner's finding of deficiency against Jane Holding Corporation (R. 54), holding that the cancellation of the indebtedness was a capital transaction falling within Article 64 of Regulations 77 (R. 54, 55), and entered its decision that there was no deficiency in income tax and excess profits tax for the year 1933 (R. 68). *Jane Holding Corporation v. Commissioner of Internal Revenue*, 38 B. T. A. 960, 970. The Circuit Court of Appeals reversed the decision of the Board (R. 523, 565). *Guy T. Helvering, Commissioner of Internal Revenue, v. Jane Holding Corporation*, 109 F. (2d) 933. Thereupon the taxpayer, Jane Holding Corporation, filed in this Court its petition for writ of certiorari, No. 999, October Term, 1939. That petition was denied, but the case is still pending on petition for rehearing.

It is respectfully submitted that there is insufficiency in the reason offered in the instant case for the granting of a writ, namely, that if the *Jane Holding Corporation* case were reversed, "it would probably follow that the judgment below in the present case should likewise be reversed."

The converse is true: If the decision of the Circuit Court of Appeals in the *Jane Holding Corporation* case stands and $2,510,222.07 is added to the income of Jane Holding Corporation, representing accruals on its books of interest in prior years, that addition to income necessarily includes the $171,249.36 which was accrued on said books for the year 1932 and which is in the instant case sought to be treated as taxable income to the Trustees in 1932. If the accrual on the books of the corporation can be treated as having been "restored" to its income, necessarily the

Trustees could not have "received" it. Both taxpayers cannot be taxed on the same item.

But it does not follow from the fact that the Commissioner's contentions in the two cases are mutually inconsistent, that he must succeed in the one if he fails in the other.

The instant case presents merely a question whether under its circumstances the Trustees, being on a cash receipts and disbursements basis, can be charged with the "constructive" receipt *in 1932* of moneys which they *did not actually receive*, and which the corporation was in no position to pay out of liquid assets. That issue may be decided adversely to the Commissioner, as it has been by the Circuit Court of Appeals, independently of the other issue in the *Jane Holding Corporation* case which arose out of an entirely separate transaction which occurred in 1933.

The petition for writ of certiorari in the instant case completely fails to state a reason for the granting of the writ, excepting one based upon alleged relationship of the instant case to the *Jane Holding Corporation* case, and that reason fails because it cannot be shown that a decision in the *Jane Holding Corporation* case adverse to the Commissioner would be determinative of his success in the instant case.

Respectfully submitted,

HARRY W. KROEGER,
Attorney for the Respondent Trustees.

DANIEL N. KIRBY,
Of Counsel.